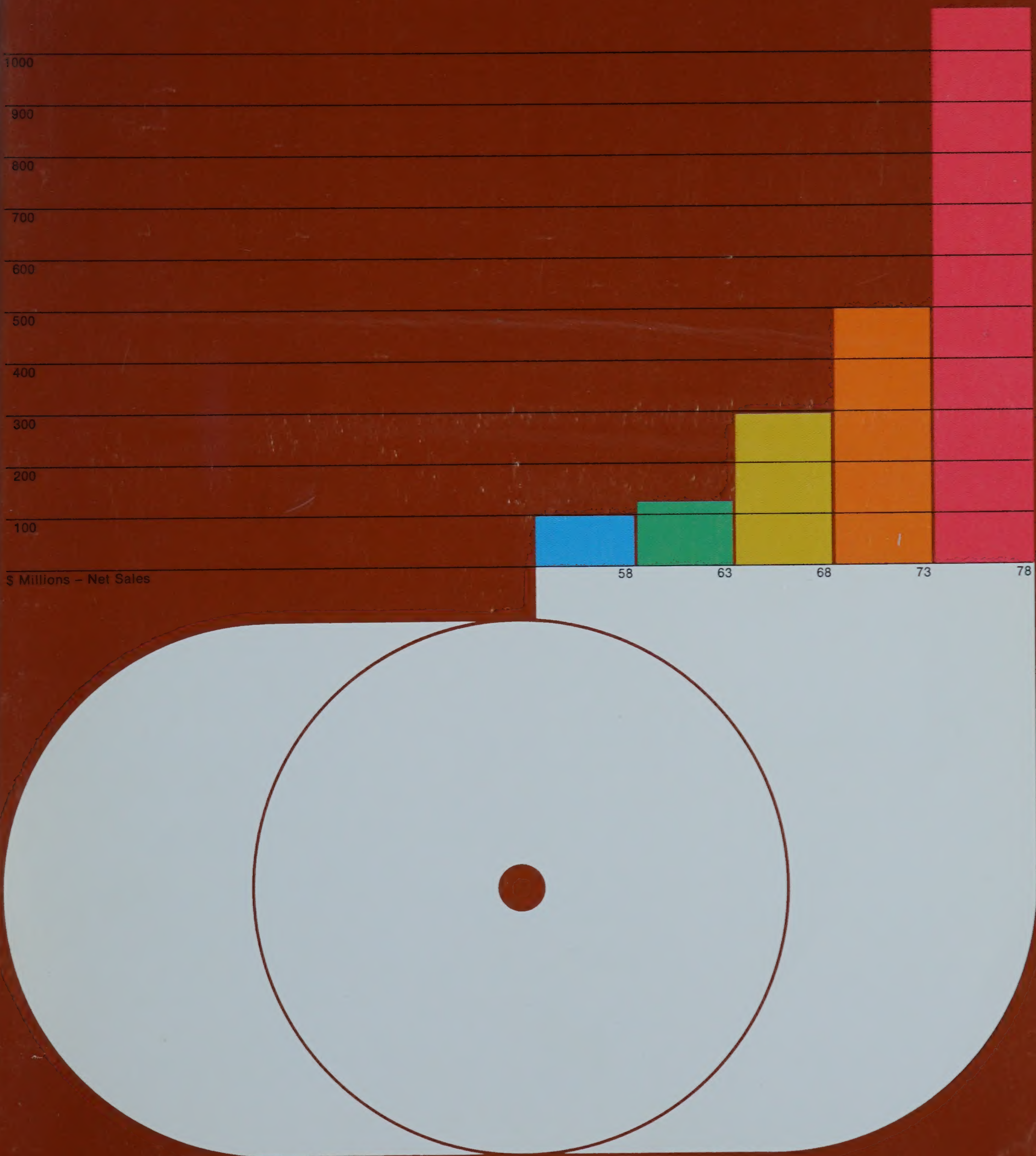
Consolidated-Bathurst Inc.
Annual Report 1978



Directors

The Hon. John B. Aird, O.C., Q.C.
Senior Partner, Aird & Berlis
Toronto, Ont.

Edward G. Byrne, Q.C.
A company director
Tucker's Town, Bermuda

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Montreal, Que.

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Deputy-Chairman
Power Corporation of Canada, Limited
Montreal, Que.

Paul Desmarais, O.C.
Chairman and Chief Executive Officer,
Power Corporation of Canada, Limited
Montreal, Que.

Edward A. Galvin
President, Poco Oil Ltd.
Calgary, Alta.

Roland Giroux
Chairman of the Board of the Corporation
Montreal, Que.

G. Arnold Hart
Director and former Chairman
of the Board and
Chief Executive Officer,
Bank of Montreal
Mountain, Ont.

Richard A. Irwin
A company director
London, Ont.

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Honorary Chairman of the Board,
Federal Industries Ltd.
Winnipeg, Man.

Robert E. Morrow, Q.C.
Counsel, Ogilvy, Montgomery, Renault,
Clarke, Kirkpatrick, Hannon & Howard
Montreal, Que.

Kenneth A. Randall
President, The Conference Board, Inc.
New York, N.Y.

The Rt. Hon. The Viscount Rothermere
Chairman,
Associated Newspapers Group Limited
London, England

John M. Seabrook
Chairman of the Board and
Chief Executive Officer,
IU International
Philadelphia, Pa.

R.M.P. Shields
Managing Director,
Associated Newspapers Group Limited
London, England

Jean Simard
Vice-President, Simcor Inc.
Montreal, Que.

Peter N. Thomson
Chairman, TIW Industries Ltd.
Nassau, Bahamas

William I.M. Turner, Jr.
President and Chief Executive Officer
of the Corporation
Montreal, Que.

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Anson C. McKim

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The Hon. John B. Aird, O.C., Q.C.
Roland Chagnon, C.A.
Peter D. Curry
G. Arnold Hart
The Rt. Hon. The Viscount Rothermere
William I.M. Turner, Jr.

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Remuneration Committee

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Paul Desmarais, O.C.
G. Arnold Hart

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President and
Chief Executive Officer

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Executive Vice-President,
Corporate Affairs

The Hon. Maurice Sauvé, P.C.
Executive Vice-President,
Administrative and Public Affairs

Jules Soucy
Vice-President, Transportation
and Corporate Services

Pierre Goyette
Vice-President, Finance

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Treasurer

Edward H. Wilton
Assistant Treasurer

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Vice-President, Planning & Systems

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Vice-President, Special Projects

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Assistant Secretary

T. Oscar Stangeland
Executive Vice-President,
Pulp and Paper

Guy Dufresne
Vice-President,
Marketing, Pulp and Paper

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Vice-President,
Technical Development
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Vice-President, Manufacturing

E.A. Thompson
Executive Vice-President, Packaging

Benedict G.R. Cotterill
Vice-President, Bag Division

Theodor W. Haiplik
Vice-President, Container Division

Senior Operating Officer of certain subsidiaries

Pulp, Paper and Lumber Sales

Consolidated Newsprint, Inc.
Consolidated-Bathurst Newsprint Limited
M. deB. Strathy, President

Consolidated-Bathurst Paper Sales Limited
C. M. Marquis, President

Consolidated Pontiac Inc.
W. J. H. Fair, President

Gillies Inc.
W. W. Gillespie, President

Packaging Operations

Domglas Inc.
J. E. Souccar, President

Europa Carton A G
W. Woitas, Chairman,
Management Committee

Consolidated-Bathurst Inc.

Registered Office
800 Dorchester Boulevard West
Montreal, Quebec H3B 1Y9
(514) 875-2160

Incorporated August 28, 1931,
under the laws of Canada

Annual Meeting
Bonaventure Hotel, Montreal
April 27, 1979 – 10:30 a.m.

Auditors
Touche Ross & Co.

Transfer Agent and Registrar
Montreal Trust Company at
Saint John, Montreal, Toronto,
Winnipeg, Calgary and Vancouver

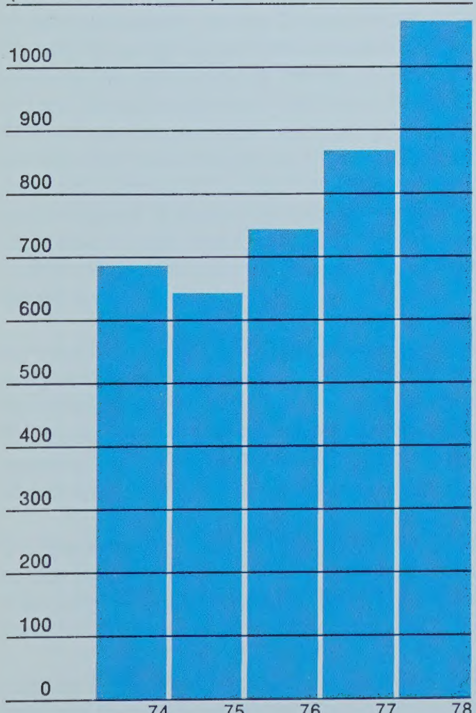
Share listings
Montreal Stock Exchange
The Toronto Stock Exchange

Contents

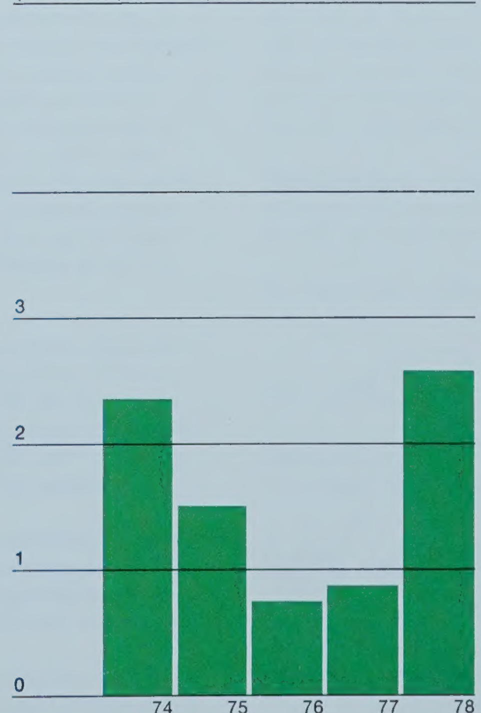
Highlights

		1978	1977
Net sales and other income		**$1,087,460,000**	$872,221,000
Earnings before extraordinary credit		**59,147,000**	21,355,000
Extraordinary credit		**1,568,000**	1,361,000
Net earnings for the year		**$ 60,715,000**	$ 22,716,000
	Per common share		
	Before extraordinary credit	**$2.60**	$0.90
	Extraordinary credit	**0.07**	0.07
	After extraordinary credit	**$2.67**	$0.97
Working capital		**$ 263,141,000**	$209,233,000
Additions to property and plant		**$ 47,475,000**	$ 53,783,000
Shares	Number of issued common shares	**22,381,992**	21,886,602
	Canadian registered	**85.5%**	85.9%
	Number of common shareholders	**13,008**	11,983
	Book value per common share	**$12.79**	$11.00
	Cash flow from operations per common share	**$ 5.25**	$ 2.96
Employees	Number of employees at end of year	**18,340**	17,725

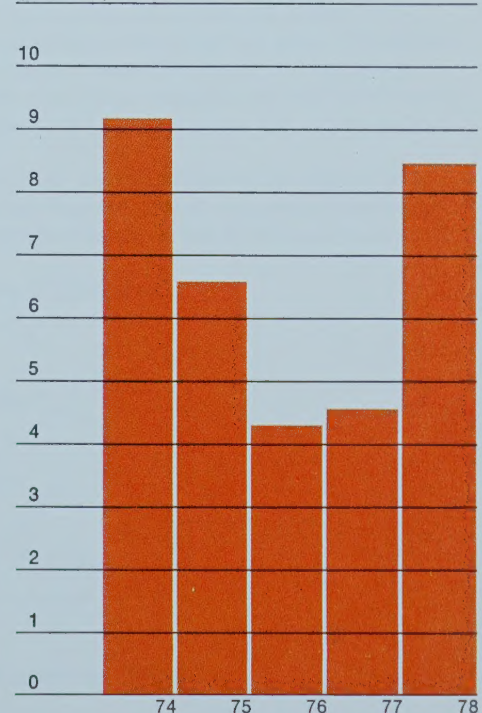
Net Sales
(in millions of dollars)



Earnings per Share
(in dollars per share)



Return on Assets
(per cent)



Roland Giroux and W.I.M. Turner, Jr. (right) at the corrugator during a visit to the Container Division's plant in Etobicoke, Ont.

Report of the Directors

To shareholders and employees:

In last year's report, we predicted improvements for 1978 in markets for newsprint and some packaging product lines and continued improvement in earnings. These improvements came more quickly than expected.

In fact, 1978 was a year of outstanding performance by our two business groups, Pulp and Paper, and Packaging. Higher volumes of newsprint shipments and a lower-valued Canadian dollar led the way to higher earnings and to sales revenue that passed the $1 billion level for the first time, albeit in 1978's inflationary dollars.

Net sales were $1,079 million in 1978, compared with $869 million in 1977, an increase of $210 million, or 24%. Earnings before extraordinary credit in 1978 were $59 million compared with $21 million in 1977. Earnings per common share, before extraordinary credit, were $2.60 compared with $0.90 in the preceding year. After extraordinary credit, earnings were $61 million, or $2.67 per share, compared with $23 million, or $0.97 per share in 1977.

The $38 million increase in earnings was attributable to improvements in both business groups. In Pulp and Paper, in addition to the strong newsprint results, pulp sales and earnings improved late in the year and other product areas were better than anticipated. In Packaging, Domglas results contributed substantially and performance improved in the Bag and Container divisions and in Europa Carton's paperboard and packaging operations.

In any evaluation of the Corporation's 1978 performance, it should be emphasized that benefits from exchange increased in absolute and relative terms. In other words, using parity of the Canadian dollar with the U.S. dollar, approximately 44% of earnings before extraordinary credit represented a benefit from exchange on sales in U.S. funds. In 1977, that ratio was about 41%. On the other side of the exchange coin, the increase in potential exchange charges on the German term bank loan, resulting from the increase during the year in the value of the Deutsche mark, had an adverse effect on earnings.

As a reflection of improved earnings and cash flow, the quarterly dividend on common shares was increased by 20% in the final quarter of 1978 to an annual rate of $0.80 per share. This was the first increase above the dividend level originally established in 1956. An extra dividend of $0.05 per common share was declared in October and paid in December.

On November 15, 1978, the share purchase warrants relating to the issue of Series C sinking fund debentures expired. By that date, 495,390 warrants had been exercised during the year for an equivalent number of Class A common shares.

Late in 1978, the Corporation was authorized by the shareholders to continue under the Canada Business Corporations Act, the Class A and Class B common shares were split three for one, the number of authorized preferred shares was increased to 6,000,000, and the name of the Corporation was changed to Consolidated-Bathurst Inc.

The Corporation officially reopened its pine lumber sawmill at Braeside, Ont., in August 1978. Construction of the plant, redesigned following a fire in the autumn of 1976, makes the Braeside mill an example of the latest technology in lumber processing.

In employee relations, two-year labour agreements were signed in 1978 with production employees of six of the Pulp and Paper Group's seven primary mills. Negotiations are continuing at the seventh mill, at Bathurst, N.B., which produces corrugating medium and unbleached kraft pulp.

In December 1978, Mr. Kenneth A. Randall was appointed a director of the Corporation. Mr. Randall is President of The Conference Board, Inc., New York City, and has wide experience in business and banking in the United States and internationally.

Capital expenditures are planned to increase to $75 million in 1979, which is comparable with $48 million spent in 1978. Management believes it important to the Corporation's competitive position that modernization and rationalization of production facilities be pressed forward.

The outlook for the Corporation in 1979 is for continued improvement in sales and earnings. A generally predicted downturn in the North American economy late in the year is not expected to affect 1979 results significantly. A substantial backlog of orders for newsprint and stronger demand for market pulp permit a positive outlook for the year. The economy in Europe, especially in West Germany, is improving and the Canadian pulp and paper industry should continue to benefit from exchange on the lower-valued Canadian dollar.

The Directors express their appreciation to the 18,340 employees of Consolidated-Bathurst for their special contribution to the improved performance of the Corporation in 1978.

On behalf of the Board of Directors,

Roland Giroux
Chairman of the Board

W. I. M. Turner, Jr.
President and Chief Executive Officer

Montreal, Quebec, February 23, 1979

Pulp and Paper Group

Within its second full year of operation as an integrated organization responsible for the production and sale of all Company forest products, Consolidated-Bathurst's Pulp and Paper Group enjoyed a year which set a variety of records, and demonstrated the industry's basic cyclicality.

Net sales attained a record level in 1978 at $523 million, which included about $32 million in sales to Packaging Group divisions. Overall, sales were 27% higher than in 1977, resulting in operating profit of $99.4 million, compared with $47.8 million in 1977. A dominant factor in Group earnings was, of course, the exchange benefit on sales in U.S. dollars to its major United States market. As indicated in the table on page 10, shipments were higher in all product lines.

In Group operations, high production volumes combined with close attention to costs, both in Manufacturing's primary mills and in Woodlands divisions, resulted in a reduction of 2% in average overall production costs per ton from the preceding year. Much of this reduction was attributable to economy measures in Woodlands and the increased use of by-product fibre which provided a small but important reduction in average wood costs – the first reduction in 15 years.

Group capital expenditures in 1978 were $23.2 million compared with $27.3 million in 1977, the reduction reflecting mainly completion of reconstruction of the Braeside sawmill. The 1979 program envisages a significantly higher level for capital expenditures.

Operations in product sectors other than newsprint and bleached kraft pulp remain generally unsatisfactory although in almost every instance the results improved significantly over 1977 and were better than anticipated. The more pressing situations are those of containerboard and unbleached kraft pulp, involving the New Richmond and Bathurst mills, and of kraft papers and boxboard, produced at Trois-Rivières and Grand'Mère, respectively.

Particular attention has been addressed to reducing costs in these situations. With the cooperation of employees, their representatives, and other interested parties, and improvements in markets, such attention has produced good results during 1978. To coordinate fully the application of woodlands, manufacturing, marketing talent and resources of the Group to these particular areas, product manager roles were established during the year for 'pulp and containerboard' and for 'kraft papers and boxboard'. This is expected to continue strong monitoring of costs, special emphasis on marketing and product mix and positive results or recommendations in the shortest delay.

In newsprint, the Corporation's most important product line, production attained 992,000 tons in 1978. Shipments totalled 1,028,471 tons, including purchased tonnage and a reduction of inventory. Newsprint output was at record levels at all four of the mills that make newsprint, and a succession of productivity records was established at each of those mills during the year.

There was a continuing improvement in the market for kraft pulps during the year, which came several months earlier than anticipated. Higher sales volume, the benefits of foreign exchange and favorable cost performance generated an operating profit of $7.8 million compared with $5.4 million in 1977.

Labour agreements were renewed for a two-year period extending into 1980 at all mills, except for Bathurst – that contract expired September 1978 and is currently under negotiation. The increases averaged 14% overall for the two-year period. Contributing to better results at the New Richmond mill was a one-year deferment in the actual application of each annual increase relative to other Company mills. In Woodlands, virtually all contracts were under negotiation in 1978 and most of these negotiations are continuing. In the Lower Mattawin and Manouan districts of the St-Maurice Division, settlements were achieved late in the year after strikes of several weeks duration. These strikes were largely due to a misunderstanding of the constraints still applicable during the AIB decontrol period. In Wood Products, settlements were negotiated at all five of the Company's sawmills. In the case of the sawmills at Notre-Dame-du-Rosaire and Bathurst, settlements followed temporary shutdowns of these operations by the Company.

Settlements with unionized employees in 1978 and the continuing interest of federal and provincial governments in assisting the industry to modernize and to meet international competition strike a note of realism that is a more accurate evaluation of the medium and long term prospects of the eastern Canadian pulp and paper industry. Its present success reflects unusually strong market demand and the favorable foreign exchange rate. Ways must be found to ensure that the industry can be competitive on a long-term basis when these factors may not be as positive as they are currently.

Newsprint manufacturing

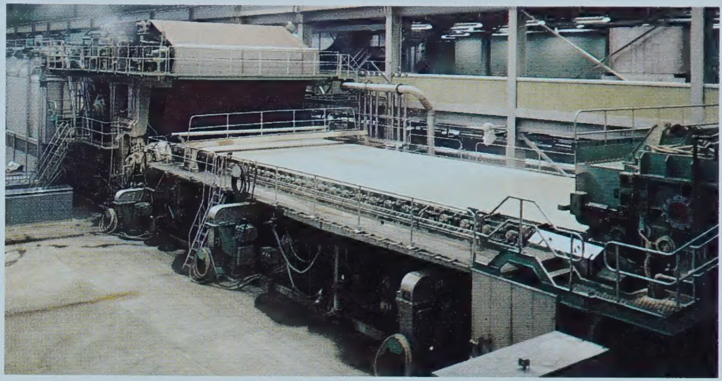
At the four newsprint-producing mills of the Company, 17 newsprint machines made almost one million tons of newsprint in 1978. The Company's Pulp and Paper Group's production achievements and range of equipment have contributed greatly to its versatility and flexibility in meeting market requirements.

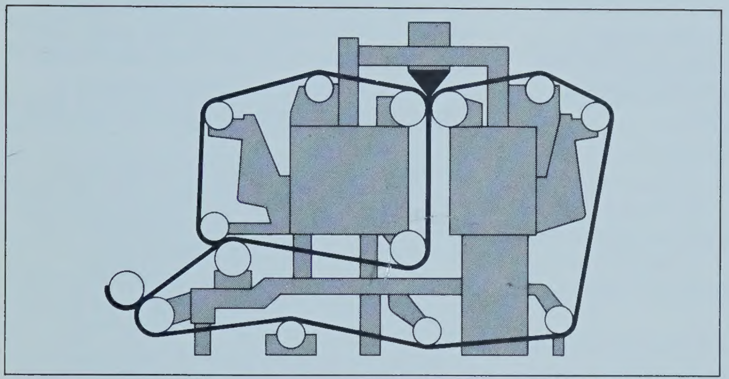
Twelve newsprint machines use the well-known fourdrinier forming units, such as that of Laurentide Division's No. 10 paper machine (top photo). In addition, Consolidated-Bathurst will soon be in the unique position of operating five twin-wire newsprint machines, manufactured by three different suppliers. The objective is to provide the range of quality newsprint required by changing markets and, at the same time, to reinforce continuously manufacturing expertise in innovative paper-making technology.

a The Manufacturing Group first introduced twin-wire formers in 1972 with installation of a Verti-Forma at the Wayagamack Division in Trois-Rivières.

b Since that time, three twin-wires of the Papriformer type have been installed, one at Belgo Division (Shawinigan) and two at Port Alfred (Ville de La Baie).

c In the spring of 1979, a twin-wire, Bel-Baie II type, will be installed at the Port Alfred mill.





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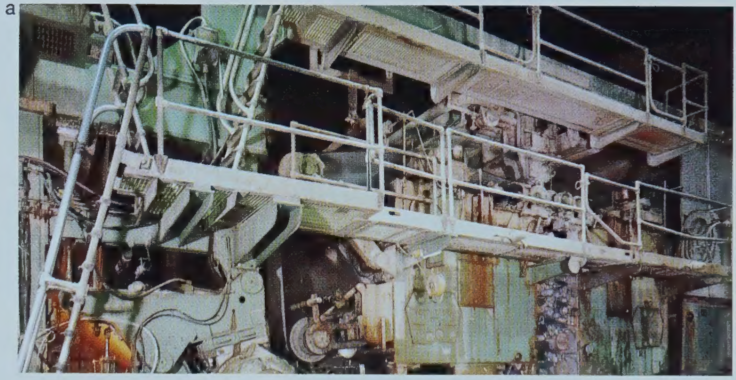

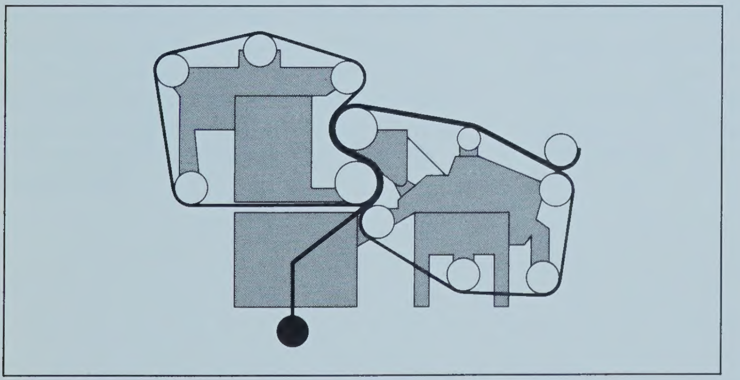

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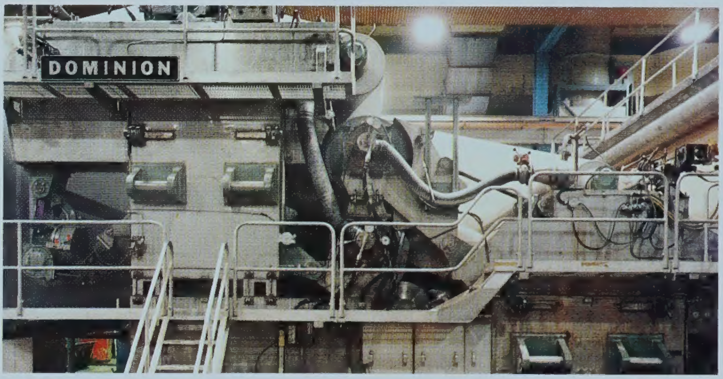

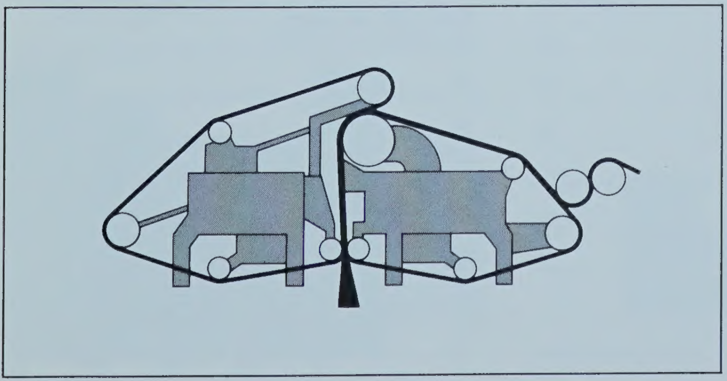

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Newsprint

Net sales of newsprint set a record in 1978 at $322.5 million with shipments totalling 1,028,471 tons. These were approximately 62% to the United States market and 19% each to Canadian and overseas markets; a decline in Canadian sales being due to lengthy strike shutdowns at two large customers. Selling prices increased in all major markets during the year.

The very strong demand for newsprint throughout the year reflected a second annual record increase in U.S. consumption which went up 6.4% in 1978 to 10,888,000 tons. The largest percentage gains were registered, as in 1977, by the 'other than daily newspaper' category.

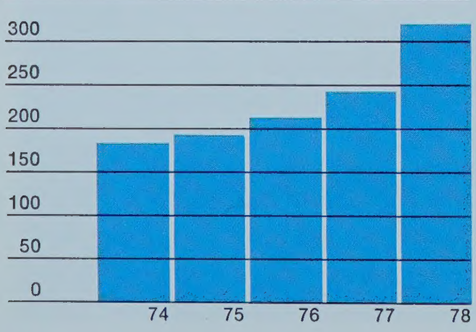
The Company's U.S. sales organization has been changed to meet the increased complexity of the market and the specialized requirements of a wider variety of printing processes using newsprint paper. In the fall of 1978, the formation of Specialty and Publisher divisions was announced by Consolidated Newsprint, Inc. The Specialty Sales Division will support concentration on specialty newsprint grades of attractive potential, based on the Company's position of leadership in serving customers for rotogravure newsprint.

Rotogravure is the fastest growing segment of the printing business. The decisions to install a super calender at Grand'Mère and to produce rotogravure newsprint on a machine at Port Alfred will enable rotogravure sales to grow with the market. This kind of specialization is also intended as a hedge against softer newsprint markets due to reduced economic activity or the impact of new capacity, particularly in the United States South.

The Publisher Sales Division will continue to serve the largest and vitally important segment of newsprint business comprised of daily and weekly newspapers. This new Division's ability to devote its efforts totally to this segment is aimed at increasing levels of service in all market areas.

Even if business activity moderates as expected, particularly in the United States, a high level of sales is expected to continue and the Company enters 1979 with a full order book.

Newsprint Net Sales
(in millions of dollars)



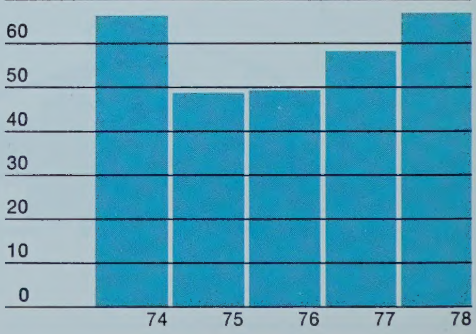
Kraft Pulp

Net sales of bleached and unbleached kraft pulps were $67.6 million in 1978. Sales revenue increased 15% on an 18% increase in sales tonnage.

Pulp consumption increased in the two largest markets, the U.S. and Western Europe. Excess inventory disappeared and the strong demand for all grades of paper in the U.S. had a multiplier effect on the demand for market pulp, with many buyers expressing interest in long-term contracts and returning to the use of higher quality pulps. Market stability improved during the year, particularly in markets for bleached kraft, which is produced at the Company's Pontiac mill at Portage-du-Fort, Quebec.

Sales and prices of unbleached kraft pulp, produced at Bathurst, New Brunswick, also improved in the second half of the year. In neither type of pulp, however, did 1978 price increases make up for the price erosion that took place during 1977 and much of 1978. The outlook for results in 1979, however, is good.

Kraft Pulp Net Sales
(in millions of dollars)



Containerboard

Net sales of containerboard (linerboard and corrugating medium) were $69.8 million during 1978 against $61.4 million in 1977. Sales tonnage increased 12.4% over 1977. About half of containerboard production is allocated to serve requirements of the Packaging Group's Container Division in its manufacture of corrugated shipping containers. Linerboard is made at New Richmond, Quebec, with a production capacity of approximately 215,000 tons per annum. Corrugating material is made at the Bathurst mill which has capacity to produce about 135,000 tons of that product annually.

Early in 1978, sales of linerboard to some export markets became unattractive in view of low prices but were more than compensated for by increased domestic sales. Corrugating medium sales increased 24% over those of 1977, mostly based on shipments to Central America. Price increases late in the year for both linerboard and corrugating medium have partially compensated for cost increases of the last three to four years. With the reduction of unit costs at the Bathurst and New Richmond mills, resulting from cost-cutting programs and concerted efforts of employees, wood suppliers and division management, operating results at the two mills have been significantly improved.

Kraft Papers and Boxboard

Net sales of kraft paper, boxboard and other papers were $33.9 million in 1978 compared with $28.9 million in 1977. After a slow start, the demand for kraft papers in Canada grew at a rapid rate in the second half of 1978. For the entire year, demand in Canada was up by 12% over the 1977 figure. Company shipments increased by 15%, to 58,800 tons in 1978. Net sales increased by 20% to $27.4 million, reflecting somewhat higher selling prices, marginally increased after three years of static or declining prices on most grades.

Increases in volumes and selling prices and tight control on costs resulted in elimination of a loss in the second half of the year, but the results for the entire year were negative. The cost reduction program is continuing and development of more profitable specialty papers is being accelerated. Increased strength in the market in 1979 is expected to translate into improved results.

Sales volume of boxboard increased by 21% in 1978. Price increases during the year were not significant and the product mix deteriorated as some customers switched to lower grades. These factors, in spite of a low increase in unit production costs, resulted in unsatisfactory financial results for this product line.

Manufacturing

Total output of the Group's seven pulp and paper mills in 1978 was 1,621,133 tons, 14.5% higher than in 1977. Cost reduction and efficiency improvement programs, together with the increased production volumes, reduced average overall production costs per ton by 2% during the year. This reduction was achieved in spite of price increases in most major components.

New annual production records were achieved at each of the four newsprint mills in 1978 and 991,795 tons of newsprint were produced, a level exceeded only in 1974, prior to shutdown of the Cap-de-la-Madeleine mill and the adoption of the lighter 30 lb basis weight standard. In pulp operations, the Pontiac mill came within 3% of its 1974 record production.

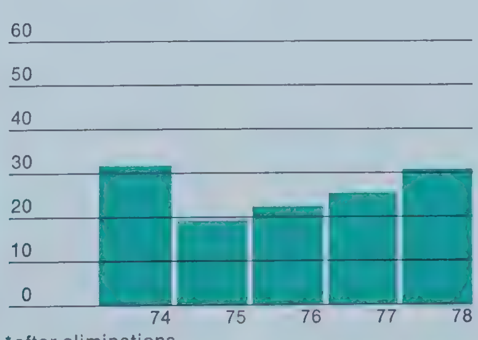
Special programs at the Bathurst and New Richmond mills and in their related woodlands operations resulted in improvements in operating costs and productivity that substantially reduced losses at these locations. Cost reduction, product rationalization and capital expenditures at the Trois-Rivières mill, begun during 1978, are also expected to improve results at that location.

Energy conservation programs provided an estimated 8% saving within the $49 million in purchases of fuel and power; for example, at the Chaleurs mill, it was possible to reduce fuel oil cost by $2 million due to increased utilization of wood refuse for steam generation and the implementation of process modifications that curtailed steam requirements.

Containerboard Net Sales*
(in millions of dollars)

*after eliminations

Kraft Paper and Boxboard Net Sales*
(in millions of dollars)



*after eliminations

Secondary boiler power for steam generation which had been available in moderate quantities for the past several years was curtailed by Hydro-Québec in December 1977 to meet demands on the system for the winter months. This meant increased utilization at the Quebec mills of coal and oil fired boilers to meet process requirements. At year end, Hydro-Québec published proposed power contract rates for 1979, 1980, 1981. These indicate an estimated 14–17% per year increase during the period.

Capital expenditures at the mills in 1978 were $18.6 million, only slightly above 1977 expenditures. About 60% of the total was spent at Port Alfred on speed-up of the No. 3 newsprint machine and related projects. These are scheduled for spring 1979 completion. About 20% of the 1978 expenditures were at Wayagamack, primarily toward cost reduction projects.

At year end, among the major projects underway were steam plant modernization at the Belgo Division in Shawinigan and a super calender installation at Laurentide for the production of a superior rotogravure quality newsprint sheet. Studies continued on a proposed chemi-thermal mechanical pulp (CTMP) plant installation at the Laurentide Division in Grand'Mère, Que. This project would benefit from the operating experience of the recently completed thermo-mechanical pulping plant at the Port Alfred mill and detailed studies by the Group's Research and Technical Services personnel.

Woodlands

Deliveries by the Group's five Woodlands divisions to its pulp and paper mills and sawmills totalled just under two million cunits in 1978: 224,000 cunits of sawlogs to sawmills and 1,771,000 cunits of wood fibre to pulp and paper mills.

The increased use of sawmill by-product fibre at the pulp and paper mills and other economy measures resulted in the first reduction in average wood cost in 15 years. Only 36% of total wood deliveries came from operations on Company limits while an additional 9% of pulp mill requirements came as residue from sawmills of the Corporation's Wood Products Group.

The trend toward integration with the lumber industry continues, with the volume of sawmill residues used reaching 770,000 cunits. As well as chips, this included about 100,000 cunits of sawdust and shavings, which are used at the Chaleurs, Pontiac and Bathurst mills.

In the Gaspé peninsula, the availability of pulpwood for purchase and of sawmill residues permitted suspension of cutting operations of the Chaleurs Woodlands Division.

The greater use generally of purchased fibre and low cost raw material was reflected in a $13 million reduction of the value of wood inventories in the bush, streams and mill block piles. At year-end, the value of these, plus woodlands stores, totalled $76 million. In addition, as a result of the low level of woodlands operations, mechanical equipment purchases and capital expenditures in 1978 for woodlands roads, camps and driving facilities were just under $1 million.

An exchange of cutting rights was effected by the Quebec Department of Lands and Forests between Consolidated-Bathurst and two large sawmills in the Lac St-Jean area. This exchange, consistent with the Corporation's policy of cooperating with local sawmills, will assure their log requirements, at no cost to the Company. At year-end, a similar exchange was under negotiation with sawmill interests in the St-Maurice Valley region.

In the framework of its long-term policy of replacing timber concessions with guaranteed cutting rights, the Government of Quebec revoked, in April 1978, the Chaleurs and part of the Ottawa limit concessions of the Company. The limits involved totalled 2,867 square miles. Negotiations are continuing with the Government as to the terms of cutting rights guarantees and on compensation for the permanent improvements and forest management expenses. Progress in this respect is slow because the future role of the industry in forest management is as yet undefined. The form of tenure of the major companies on crown lands is also under active discussion in Ontario and New Brunswick.

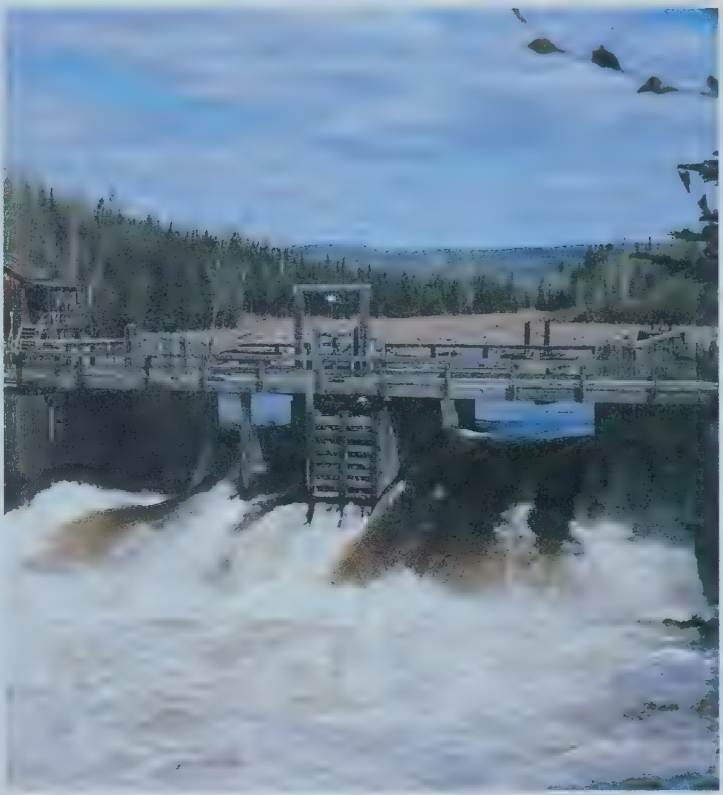
Shipments

Pulp and Paper Group Products	1978	1977	1976	1975	1974
(in thousands of tons)					
Newsprint	**1,028**	865	917	842	1,006
Pulp	**242**	205	164	147	235
Containerboard	**307**	273	227	208	317
Kraft paper, boxboard and other paper	**91**	80	68	59	108
(in thousands of board feet)					
Lumber	**128,159**	91,464	95,692	71,157	67,673

Conifer by moonlight suggests the boreal forest resource in three provinces that is the basis of the Company's pulp and paper operations.

Typical wood holding area on a small Quebec river. Transportation by water of much of the industry's wood supply is still essential. In 1978, Consolidated-Bathurst moved more than 400,000 cunits en route to its mills by river drive.

Mechanization plays an important and ever-adapting role in woodlands operations to provide large volumes of wood at optimum cost. Here, with no workers on the forest floor, trees are sheared off and (foreground) flail-debranched.



The Company's pine sawmill at Braeside. Redesigned and rebuilt following a fire in 1976, it is the most modern lumber processing facility in Eastern Canada.

Wood Products

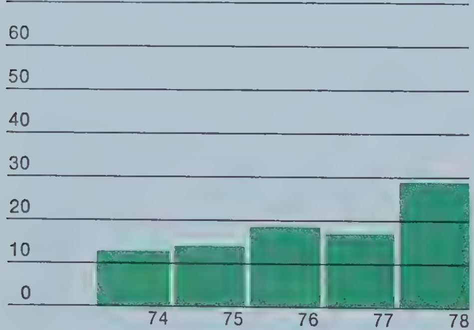
The Wood Products Group manages the pine sawmill at Braeside, Ont. and three spruce sawmills in Quebec. The Group's marketing company, Gillies Inc., is also responsible for sale of the production of the Company's sawmill at Bathurst, N.B.

Lumber markets during 1978 were good. Prices increased for both pine and spruce lumber and the net sales of the Group amounted to $28.5 million. Overseas markets for Quebec spruce were expanded considerably and the overall volume in these markets amounted to 27% of spruce sales. The thrust to diversify into overseas markets for spruce lumber is continuing and contracts have already been completed for a large volume in 1979 at prices substantially better than in 1978.

The sawmill at Bathurst was acquired in 1977 and converted to stud production. In its redesigned form, it started operations on August 1, 1978. This sawmill is capable of supplying, in the form of chips and sawdust, most of the softwood required for the Bathurst unbleached kraft pulp mill.

The highlight of the year was the official reopening of the pine mill at Braeside in August. The facilities destroyed by fire in 1976 were completely redesigned. Braeside is now one of the most modern lumber sorting, planing and lumber packaging installations in North America.

Lumber Net Sales
(in millions of dollars)



Packaging Group

The Consolidated-Bathurst Packaging Group has profit responsibility for the manufacture and sale of all packaging and related products made by the Company and its subsidiaries in Canada and in the Federal Republic of Germany. Major operating companies of the Group are Consolidated-Bathurst Packaging Limited, which operates Bag and Container divisions, Domglas Inc. and subsidiaries and, in Germany, Europa Carton AG and its subsidiaries. Manufacturing is carried on at 23 Canadian plants from Saint John, N.B. to Vancouver, B.C. and the Company operates at 20 locations across Germany. The product range is highly diversified and the organizational philosophy of the Group emphasizes decentralized profit responsibility. Packaging Group executive offices are located at Sheridan Park in Mississauga, Ontario.

In Canada, Consolidated-Bathurst Packaging product lines range from corrugated containers, multi-wall paper bags and heavy duty plastic bags to high-speed bag filling and weighing equipment and, increasingly important, laminated and coated flexible packaging products. Domglas makes glass containers, industrial glass products and its Twinpak subsidiary produces a wide range of plastic bottles and containers, injection and extrusion moulded plastic products, and supplies packaging machinery systems. In Germany, Group products include paperboard packaging materials, corrugated shipping containers, folding cartons and graphic design services.

In addition, Domglas participates in Libbey-St. Clair Inc. which is a joint venture company formed in 1978. It is based on a merger of Domglas' St. Clair Division, which manufactured and sold table glassware, with the Canadian operations of the Libbey Division of Owens-Illinois. This new company purchased the Wallaceburg production facilities of Domglas Inc.

Net sales of the Group in 1978 were \$587.9 million, the third year in succession in which the annual increase has been 19% over sales of the preceding year. Of these sales, \$328.9 million were attributable to Canadian operations and \$259.0 million to those in Europe. Operating profit of the Group was \$39.3 million in 1978, compared with \$24.9 million in 1977. As indicated in the reports that follow, sales and operating profits of each of the Group's four basic divisions were appreciably higher than in 1977, with some of the gain of the European Division attributable to a favourable exchange rate.

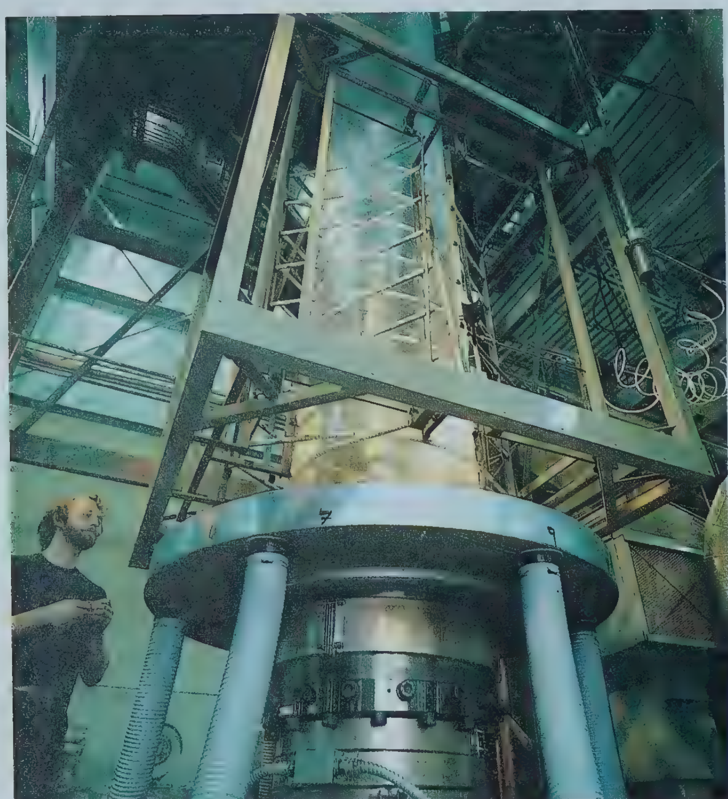
1 Blown-film extruder at Calgary bag plant turns resin into the continuous polyethylene tube that is the first stage in the production of heavy-duty plastic industrial bags, used mainly in packaging a variety of granular materials.

2 Twinpak's bag-in-box concept, highly successful in institutional milk packaging, is winning a broader market in this adaptation to dispensing wines and other products. Plastic bags, filling systems by Twinpak, attractively printed corrugated containers from the Container Division.

3 Vario box by ECA's Folding Carton Division received high customer attention. Shown here in heart shape, the basic product is a range of set-up boxes, especially for candy, that can be made in sizes up to 20x30 cms in a variety of special shapes including: apple, clover-leaf, lemon, pear, horseshoe.

4 Colorful bag suggests the highly competitive marketing of pet foods in retail outlets which has created the need for sophisticated surface design and more colorful printing on the traditional multi-wall bag.

1



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Consolidated-Bathurst Packaging Limited – Bag Division

Net sales of the Bag Division in 1978 totalled \$37.6 million, 27% or \$7.9 million higher than in 1977. Division earnings improved substantially. Factors contributing to improved earnings were higher sales volumes in all Division products, the benefits of a rigid cost control program, and a marked improvement in productivity.

The increased utilization of four extrusion coater-laminators at plants in Quebec, Ontario and British Columbia has strengthened the Division's position as a major supplier of flexible packaging materials, such as heavy duty laminated-coated wrap for lumber. This material serves to protect a vital construction product that enjoys a global market and offers excellent market growth potential. At the opposite end of this product spectrum are polyethylene – coated papers such as popsicle wrap and sugar pouch stock, the production of which requires highly specialized skills and control.

The provision of high-speed filling and weighing equipment for industrial bags continues to play an important role in Division strategy and remains a major factor in providing customers with a total packaging service. One high-speed pre-weigh air rotary valve packer installed during 1978 in Western Canada (the first in the Americas) is capable of filling fertilizer into 50 lb bags at speeds up to 1 ton per minute.

During the year, most customers completed conversion to the metric system and began rebuilding inventories. The demand for multi-wall paper bags continued to increase while the kraft paper market in North America experienced production shortfalls due to strikes in the Western U.S. and an above-normal demand for sack kraft from converters.

Capital expenditures during the year totalled \$1.7 million and included a six-colour press and related plate-making equipment for Cap-de-la-Madeleine, a plastic bag line at Brantford and packers to be leased to customers.

– Container Division

Net sales of the Container Division in 1978 were \$93.8 million, an increase of 8.6% or \$7.4 million over 1977. Shipments for the year 1978 were up over the previous year by almost 6% and Division earnings showed a marked improvement over those of 1977. Sales volumes were higher in all market areas served by the Division although the Hamilton plant was closed for over a month early in the year as a result of labour difficulties.

Despite good market conditions, selling prices for the Division's products continued under severe competitive pressure through 1978 even though costs continued to escalate rapidly. At year-end, however, average selling prices per thousand square feet were marginally ahead of those of the previous year.

During the year, the Division continued to emphasize the reduction of costs through increased productivity. All plants now operate with measured day work standards to provide a better environment for implementation of capital and method-related improvements.

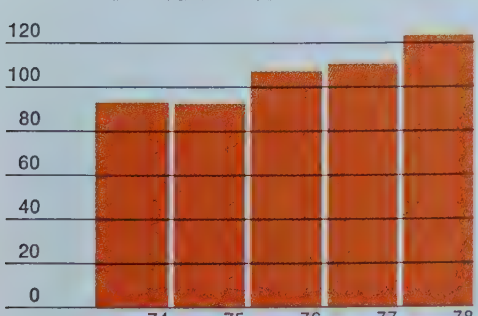
In 1978, \$2.7 million was spent on capital projects. These projects included changes on a number of the Division's basic corrugator units, including the installation of a 'down-stacker' at the Whitby plant and of a direct-drive cut-off knife in Hamilton. Concentration over several years in this critical production area is showing excellent results. Other capital projects included additional flexo-folder-gluer capacity for the Quebec area, additional specialty equipment in the form of high-speed assembly machinery for beer boxes, installed at the Saint John plant, and a fully automatic litho-laminator at Etobicoke.

Domglas Inc.

Consolidated net sales of Domglas (including those of Ampak Limited and Twinpak Ltd.) rose 12% to a record \$204.5 million. This was after excluding fourth quarter sales of the St. Clair tableware division which were consolidated into Libbey-St. Clair Inc.

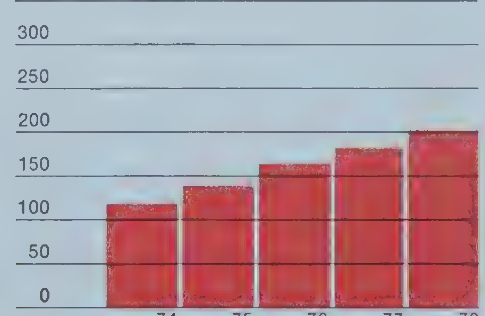
Major increases in glass container exports (encouraged by the lower value of the Canadian dollar) and improved domestic shipments to the beer, liquor and wine industries enabled the company to reach an all-time high in glass container volumes. Higher prices for glass containers and tableware products also contributed to increased revenue.

Packaging in Canada Net Sales *
(in millions of dollars)



*after eliminations

Domglas Net Sales
(in millions of dollars)



Operating profits increased to $18.6 million, a 40% increase over the record $13.3 million achieved in 1977. This performance reflects both higher sales and good productivity gains in glass manufacturing. In addition, the company realized a pre-tax capital gain of $3.2 million on disposition of Wallaceburg tableware production facilities to Libbey-St. Clair Inc. on October 1, 1978.

Libbey-St. Clair is a joint venture owned 50% by Domglas Inc. and 50% by the Libbey Division of Owens-Illinois of Toledo, Ohio, the largest manufacturer of tableware products in the United States. Formation of this company strengthens the sales support and market position for tableware and will accelerate the development and manufacture of various new lines in Canada. Access to new technologies and worldwide marketing opportunities will also serve to broaden the company's base in tableware. Libbey-St. Clair Inc. expects to begin the manufacture of stemware by the end of 1979. Over a period of three years, the plant at Wallaceburg will be fully converted into a specialty tableware operation.

The transfer of the manufacture of glass containers out of Wallaceburg will involve expansion of the company's glass container operations at Hamilton. Accordingly, a major expansion and rebuild program was started at that plant in December 1978. In 1978 as well, a number of important projects were begun to respond to the increasing demand for coloured glass containers, especially for the beer and wine industries and for export to the U.S. These include: a third furnace to be installed at Bramalea; additional lines being installed at Burnaby, B.C. and at Redcliff, Alta.; and a larger batch plant at Pointe St. Charles, Que. to provide tonnage to meet anticipated growth.

Domglas capital expenditures, excluding major furnace rebuilds, totalled $10.5 million and were $1.3 million higher than in 1977. During the year, the company effected a change in name to Domglas Inc. and consolidated its corporate management functions at Sheridan Park in Mississauga, Ontario.

A special personnel training program aimed at improving technical skills was initiated in 1978 in order to strengthen operations and a new senior technical committee made major strides in improving forming operations.

Subsidiaries and Divisions

The major Domglas subsidiaries and divisions are Twinpak Ltd., Ampak Limited, National Pressed Glass and Dorchester Electronics. Twinpak, at plants in Mississauga, Ont., Montreal, Dorval and Granby, Que., produces a wide range of plastic containers and packaging products. Ampak is a national distributor of diversified glass and plastic packaging products. National Pressed Glass makes fuse-plug bodies while Dorchester produces popular priced home entertainment equipment. As previously mentioned, Domglas also participates in tumbler and tableware markets via Libbey-St. Clair Inc.

For the second year, National Pressed Glass made significant gains over the previous year and generated highly satisfactory results. Sales revenue at the company's other subsidiaries rose only marginally as competitive pressures in Ampak and Twinpak marketing areas precluded price increases. In Twinpak, good control of expenses offset cost increases and weak markets so that, in spite of static sales, Twinpak's operating profits in 1978 were almost identical to those of 1977.

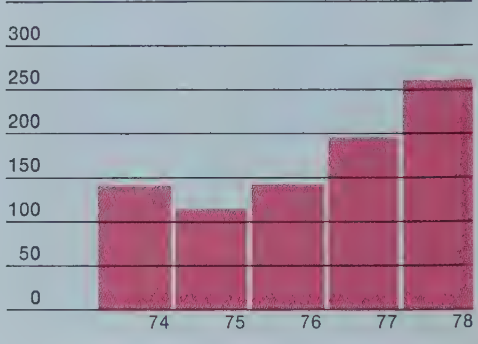
Gains were also made in launching new Twinpak products. Adaptation of the bag-in-box concept for non-dairy applications was highly successful. The use of this container for wines and other products will enable Twinpak to serve broader markets. Progress was also recorded in plastic blow-moulded container sales, in spite of intense competition.

Ampak encountered strong competition in 1978 which caused sales to remain static and margins to decrease. Dorchester Electronics experienced heavy start-up costs and some delay in launching several new products, adversely affecting that Division's performance.

Europa Carton AG

With headquarters in Hamburg, Europa Carton AG is a strong force in packaging in the Federal Republic of Germany. Its three major operating groups are paper, container and folding carton divisions. The Paper Division has a containerboard mill at Viersen, a boxboard mill at Hoya and, to provide basic raw material, three waste paper collection centres. Eight corrugated container plants throughout

ECA Net Sales
(in millions of dollars)



5 ECA flags with basic 'cb' symbol fly over company pavilion at INTERPACK in Düsseldorf. Exhibit conception by ECA's highly regarded Design Institute reflects graphics professionalism of the company. New packaging products were featured by some 1200 exhibitors at the world famous event, held June 8-14 in 1978.

6 A sampling of Libbey-St. Clair creative glassware. New market potential, production and design possibilities have been opened up by partnership in a new joint venture company of two long-established glassware producers. These were the St. Clair Division of Domglas at Wallaceburg, Ont. and the Libbey Division of Owens-Illinois.

7 A popular style of moulded glass bowl gets a surface polishing on the glazing line at Libbey-St. Clair's Wallaceburg plant. Machine-made stemware will soon be produced there, for the first time anywhere in Canada.

5

6

7

Germany make the company's Container Division one of the two largest manufacturers of shipping container products in Germany. The Folding Carton Division, with five plants, is the country's unquestioned leader in the production of folding cartons, used mainly in consumer packaging.

During 1978, the real growth rate in Germany improved only slightly, from 2.6% in 1977 to 3.4% in 1978. The paper industry continued to suffer from tight competitive and profit situations. Although there was an improvement in capacity utilization during the second half of 1978, idle productive capacity in the paper and converting industries adversely affected results.

In 1978, net sales of ECA increased 4.8% to 397.4 million Deutsche marks, with the increase being mainly attributable to the incorporation for a full year of the results of acquisitions in 1977: folding carton plants at Munich and Frankfurt and a corrugated container plant at Plattling. Although much improved over those of 1977, earnings of the company in 1978 are regarded by its management as unsatisfactory.

Sharp price competition was aggravated by the effect of international currency devaluations and the strength of the Deutsche mark, which increased pressure from imports. At the same time, floor prices imposed by the European Economic Community on imported U.S. kraftliner reduced the margin of the corrugated converting industry. Under such conditions, increased costs could not be passed on to users and profit margins were reduced.

Paper Division results reflected reduced demand for waste paper and sharply declining prices while demand for boxboard was uneven in the face of strong import competition. The level of containerboard production was satisfactory based on supply to the company's own corrugated plants but transfer prices, at market, were inadequate. Boxboard production increased by 12.5% to 42,300 metric tonnes. However, a price increase implemented by mid 1978 had to be withdrawn in full by year-end and improved plant efficiency could not by itself overcome an inadequate profit situation. Waste paper activities were concentrated at three centres with shutdown of a centre in Hamburg in mid 1978.

The *Container Division* with its eight corrugated container plants increased production by 12.5%. Reconstruction and extension work at the Jülich plant was completed, while in the other plants capital investment was limited to essential modernization measures.

Net sales of the *Folding Carton Division* were 125.1 million Deutsche marks. Plant equipment was upgraded with installation of six-colour and four-colour offset presses for high quality printing at Bremen and Munich plants, respectively. Development and introduction of new packaging systems strengthened the company's competitive position.

In 1978, the company concentrated its efforts on stabilizing its market position and on competitiveness. Its investment policy placed emphasis on increases in productivity and adaptation of production potential to market requirements. For the first time, Europa Carton was represented at INTERPACK, the world famous packaging exposition in Düsseldorf, where the company demonstrated the broad scope of its production and service capabilities. This exhibit reflected ECA's strong national and international interests.

Shipments

Packaging Group Products	**1978**	1977	1976	1975	1974
Bags (tons)	**27,142**	23,550	24,333	21,438	33,258
Containers (millions of square feet)	**5,973**	5,627	5,281	4,733	4,691
Folding cartons (tons)	**44,180**	38,010	21,050	19,000	17,065
Paperboard (tons)	**84,250**	94,370	89,100	78,500	81,400
Glass (tons)	**563,426**	504,976	500,283	528,284	544,172

Financial Review

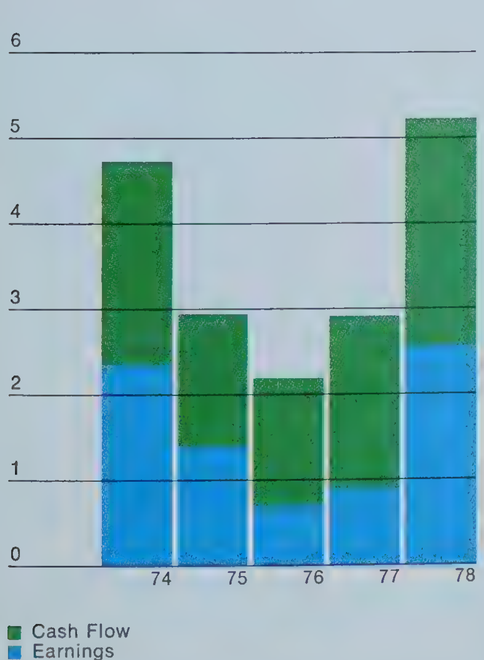
Record sales of $1,079 million and net earnings of $61 million significantly strengthened the Corporation's financial position in 1978. The return on common shareholders' equity rose to 21.8% in 1978, from 8.5% in 1977. Funds provided from operations were $120 million compared with $66 million in 1977.

The higher cash flow from operations and the issuance of $24 million of preferred and common shares permitted the Corporation to bring about a significant improvement in the debt/equity ratio. During the year, short-term debt was virtually eliminated. It was reduced by $42 million to $2 million at December 31, 1978. In addition, long-term debt was reduced by $17 million to $228 million at the end of 1978, for a total debt reduction of $59 million. As a result, the ratio of short and long-term debt to shareholders' equity improved from 53/47 at the end of 1977 to 42/58 at the end of 1978. Also, at the end of 1978, cash and short-term deposits increased by $19 million to $34 million.

Working capital at the end of 1978 was $263 million, an increase of 26% from the $209 million level at the end of 1977. The working capital ratio improved from 2.2 at December 31, 1977, to 2.7 at December 31, 1978.

In the fourth quarter, the Corporation capitalized $73 million out of retained earnings, equivalent to $3.25 per common share. This capitalization was effected by the transfer from retained earnings to the capital accounts of the outstanding Class A and Class B common shares. The purpose of capitalizing retained earnings is to increase the paid-up capital value of the common shares on a tax-free basis.

Earnings and Cash Flow per common share before extraordinary items
(in dollars per share)



In the fourth quarter, the Corporation sold to Abitibi Paper Company Ltd., for $23 per share, all its holdings of common shares of The Price Company Limited. The disposal of this investment resulted in an extraordinary credit to earnings of $1.6 million, or $0.07 per share in 1978.

In the same quarter, the Corporation purchased 1,740,700 common shares of Abitibi Paper Company Ltd. for $31.4 million, or approximately $18 per share. These shares represent 9.4% of the outstanding common shares of that company.

Included in Other income is a capital gain of $3.2 million on the sale, in October 1978, of the Domglas production facilities in Wallaceburg, Ont., to Libbey – St. Clair Inc., a newly formed tableware joint venture. Domglas Inc. and Owens – Illinois Inc. each have a 50% interest in this venture.

Quarterly earnings before extraordinary credit per common share in 1978 and 1977 were:

	1978	1977
First quarter	**$0.22**	$ —
Second quarter	**0.58**	0.28
Third quarter	**0.82**	0.19
Fourth quarter	**0.98**	0.43
	$2.60	$0.90

At December 31, 1978, the Corporation had contract commitments to sell $86 million in U.S. currency at an average exchange rate of US $1 = Cdn $1.1744 at various dates throughout 1979. The amounts of U.S. currency that the Corporation is required to provide under these contracts do not exceed 50% of the anticipated receipts from U.S. dollar sales in any month in 1979.

The table on page 20 provides information on net sales, operating profit and capital expenditures segmented by business groups and principal product lines.

In spite of continuing research by accounting bodies for a comprehensive inflation accounting system, none has yet gained general acceptance. An interim method has been used to develop the statement on page 32 which illustrates the impact of inflation on funds generated from operations.

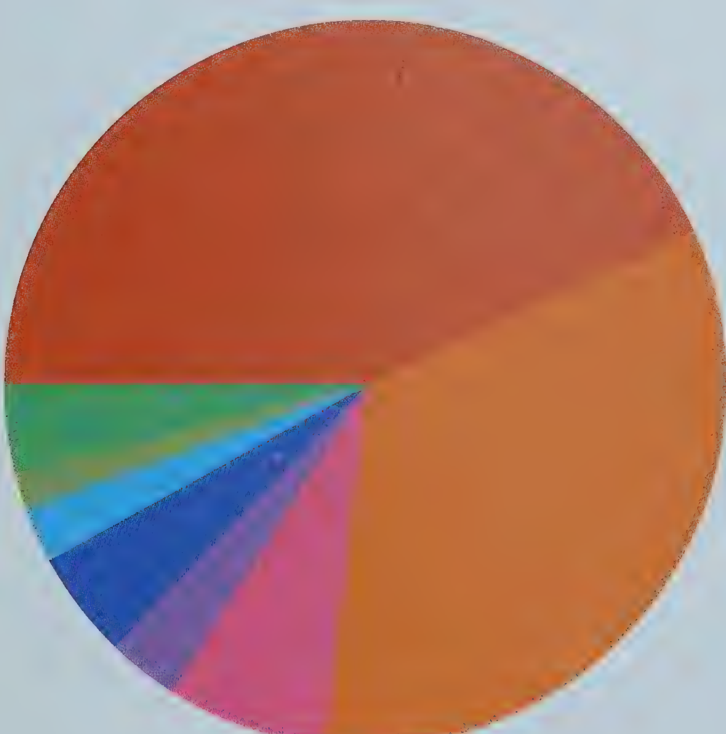
Segmented Information

	1978			1977		
	Net Sales	Operating Profit	Capital Expenditures	Net Sales	Operating Profit	Capital Expenditures
						(in millions of dollars)
Pulp and Paper						
Newsprint	**$ 322.5**	**$ 89.5**	**$ 16.8**	$ 244.4	$ 50.2	$ 15.5
Pulp	**67.6**	**7.8**	**0.5**	58.8	5.4	1.2
Containerboard	**69.8**	**2.7**	**1.3**	61.4	(5.1)	1.6
Kraft paper, boxboard and other paper	**33.9**	**(1.4)**	**0.5**	28.9	(0.8)	0.5
Wood products	**29.2**	**0.8**	**4.1**	16.7	(1.9)	8.5
	523.0	**99.4**	**23.2**	410.2	47.8	27.3
Packaging						
Packaging in Canada	**124.4**	**9.6**	**4.4**	111.1	6.3	2.5
Domglas	**204.5**	**18.6**	**12.1**	183.1	13.3	11.9
Overseas packaging	**259.0**	**11.1**	**7.8**	197.6	5.3	12.1
	587.9	**39.3**	**24.3**	491.8	24.9	26.5
Eliminations	**(32.1)**	**(1.2)**	**—**	(33.1)	1.1	—
	$1,078.8	**137.5**	**$ 47.5**	$ 868.9	73.8	$ 53.8
Interest expense		**26.9**			26.8	
Potential exchange charges on German term bank loan		**10.4**			7.5	
Other corporate expenses – net		**4.4**			7.7	
Earnings before income taxes, minority interest and extraordinary credit		**$ 95.8**			$ 31.8	

Eliminations represent net sales and corresponding changes in unrealized inventory profits between segments.
The 1977 figures have been restated to conform with the presentation adopted in 1978.

Distribution of Revenue

	1978	1977
	(in millions of dollars)	
Materials, supplies, etc.	**$ 468**	$373
Wages, salaries and fringe benefits	**366**	325
Fuel and power	**78**	66
Depreciation and depletion	**36**	32
Federal, provincial and municipal direct taxes	**52**	28
Interest	**27**	27
Dividends	**19**	16
Retained earnings (excluding extraordinary items)	**41**	5
	$1,087	$872



Net Sales by Geographical Market
(in millions of dollars)

Sales, Property and Plant, Employees, Shareholders and Shares by Province and Country at December 31, 1978

	Net Sales	Property and Plant Net	Number of Em-ployees	Number of Common Share-holders	Number of Common Shares
	(in millions of dollars)				
Alberta	$ 15.3	$ 5.7	632	401	262,102
British Columbia	22.5	4.9	492	654	325,946
Manitoba	13.2	0.9	114	337	363,404
New Brunswick	10.0	14.2	762	225	62,204
Newfoundland	2.2	—	—	17	12,028
Nova Scotia	6.5	0.1	2	172	117,212
Ontario	220.1	58.6	4,264	4,669	3,964,066
Prince Edward Island	0.5	—	—	16	6,626
Quebec	167.0	255.7	8,948	4,787	13,982,450
Saskatchewan	3.3	0.1	2	133	32,805
Yukon and territories	—	—	—	2	375
Canada	460.6	340.2	15,216	11,413	19,129,218
United Kingdom	47.4	0.2	11	132	2,809,862
United States	272.0	—	28	427	288,155
West Germany	260.5	51.7	3,085	956	3,018
Other countries	38.3	—	—	80	151,739
	$1,078.8	$392.1	18,340	13,008	22,381,992

Statement of Consolidated Earnings for the year ended December 31, 1978

		1978	1977
		(in thousands of dollars)	
Net sales and other income	Net sales	**$1,078,843**	$868,865
	Other income		
	Income from investments and short-term deposits	**4,955**	2,381
	Gain from debt retirement and disposal of property and plant	**3,662**	975
		1,087,460	872,221
Costs and expenses	Cost of goods sold	**845,830**	716,436
	Administrative and selling expenses	**72,474**	57,172
	Depreciation and depletion	**36,022**	32,484
	Interest on debt issued for terms in excess of one year	**23,118**	19,011
	Interest on other debt	**3,812**	7,812
	Potential exchange charges on German term bank loan (note 8)	**10,440**	7,510
		991,696	840,425
		95,764	31,796
	Income taxes (note 2)	**36,350**	10,038
	Minority interest	**267**	403
Earnings before extraordinary credit		**59,147**	21,355
	Extraordinary credit (note 3)	**1,568**	1,361
Net earnings for the year		**$ 60,715**	$ 22,716
Earnings per common share	Before extraordinary credit	**$2.60**	$0.90
	Extraordinary credit	**0.07**	0.07
	After extraordinary credit	**$2.67**	$0.97

Statement of Consolidated Retained Earnings for the year ended December 31, 1978

		1978	1977
Retained earnings at beginning of year		**$150,940**	$144,384
Transfer to common shares (note 11)		**72,741**	—
		78,199	144,384
Net earnings for the year		**60,715**	22,716
		138,914	167,100
Dividends	Preferred	**2,057**	1,569
	Common	**16,540**	14,591
Retained earnings at end of year		**$120,317**	$150,940
Dividends	Per preferred share		
	1966 Series	**$1.50**	$1.50
	1978 Series	**0.64**	—
	Per common share	**$0.75**	$0.67

Consolidated Balance Sheet as at December 31, 1978

		1978	1977
Assets		(in thousands of dollars)	
Current assets	Cash and short-term deposits	**$ 33,762**	$ 14,536
	Note receivable from joint venture	**11,573**	—
	Accounts receivable	**160,627**	128,748
	Inventories (note 4)	**209,192**	227,721
	Prepaid expenses	**7,075**	6,945
		422,229	377,950
Property and plant	Mills, plants and other properties	**784,661**	769,237
	Less: Accumulated depreciation and depletion (note 5)	**392,549**	375,895
		392,112	393,342
Investments and other assets	Investments (note 6)	**52,702**	30,851
	Advances to trustees under stock option and purchase plans (note 7)	**1,577**	1,685
	Unamortized long-term debt expense	**1,844**	2,200
	Deferred charges	**2,480**	2,763
		58,603	37,499
		$872,944	$808,791

Liabilities and Shareholders' Equity

		1978	1977
Current liabilities	Due to banks and bankers' acceptances	**$ 1,779**	$ 33,670
	Short-term notes payable	**—**	10,500
	Accounts payable and accrued expenses	**115,822**	98,200
	Taxes and stumpage dues	**30,798**	16,644
	Dividends payable	**929**	670
	Long-term debt due within one year	**9,760**	9,033
		159,088	168,717
Provisions	German pensions (note 12)	**12,829**	11,199
	Contingent charges (note 8)	**30,708**	20,268
		43,537	31,467
Long-term debt	(note 9)	**228,231**	245,647
Deferred income taxes		**106,812**	90,175
Minority interest	(note 10)	**2,832**	5,896
Shareholders' equity	Stated capital (note 11)		
	Preferred shares	**46,279**	26,145
	Common shares	**165,848**	89,804
	Retained earnings (note 11)	**120,317**	150,940
		332,444	266,889
		$872,944	$808,791

On behalf of the Board:

Roland Giroux, Director
W. I. M. Turner, Jr., Director

Statement of Consolidated Changes in Financial Position for the year ended December 31, 1978

		1978	1977
		(in thousands of dollars)	
Working capital at beginning of year		**$209,233**	$157,860
Source of working capital	Earnings before extraordinary credit	**59,147**	21,355
	Add (deduct)		
	Depreciation and depletion	**36,022**	32,484
	Potential exchange charges on German term bank loan (note 8)	**10,440**	7,510
	Deferred income taxes	**16,144**	3,338
	Provision for German pensions	**1,630**	2,494
	Other items – net	**(3,753)**	(843)
	Total from operations	**119,630**	66,338
	Issuance of preferred shares	**21,081**	—
	Issuance of common shares	**3,303**	1
	Proceeds from disposal of investments	**19,538**	39
	Increase in long-term debt	**10,543**	101,628
	Net increase in working capital resulting from the sale of a glass plant to the joint venture	**7,050**	—
	Proceeds from disposal of property and plant	**4,361**	2,000
		185,506	170,006
Application of working capital	Additions to property and plant	**47,475**	53,783
	Reduction in long-term debt	**27,608**	35,707
	Acquisition of investments	**34,039**	4,695
	Dividends on common and preferred shares	**18,597**	16,160
	Dividends paid by subsidiary to minority interest	**185**	209
	Acquisition of additional shares of subsidiary companies	**2,793**	88
	Purchase of preferred shares for cancellation (note 11)	**749**	654
	Net decrease in working capital resulting from acquisition of subsidiary companies	**—**	6,037
	Long-term debt expense	**—**	1,009
	Other items – net	**152**	291
		131,598	118,633
Increase in working capital during year		**53,908**	51,373
Working capital at end of year		**$263,141**	$209,233

Auditors' Report

The Shareholders,
Consolidated-Bathurst Inc.

We have examined the consolidated balance sheet of Consolidated-Bathurst Inc. as at December 31, 1978 and the statements of consolidated earnings, retained earnings, and changes in financial position for the year then ended. For Consolidated-Bathurst Inc. and those subsidiaries of which we are the auditors, our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. With respect to those subsidiaries of which we are not the auditors, we have carried out such inquiries and examinations as we considered necessary in order to accept, for purposes of consolidation, the reports of the other auditors.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Touche Ross & Co.
Chartered Accountants

Montreal, Quebec
February 23, 1979

Summary of Significant Accounting Policies

The Corporation follows generally accepted accounting principles in the preparation of its consolidated financial statements and their application is consistent with that of the preceding year. The common shares were split three for one on November 23, 1978. For comparison purposes, the number of common shares, earnings and dividends per common share relating to 1977 have been restated to reflect the stock split.

Principles of consolidation

The consolidated financial statements include the accounts of all subsidiary companies with provision being made for the interests of minority shareholders. All significant inter-company items are eliminated. The acquisitions of all subsidiary companies are accounted for on a purchase basis and earnings are included in the consolidated financial statements from the date of acquisition. The excess of the cost of the Corporation's investments in subsidiaries over the net book value of the assets acquired is allocated to the particular assets acquired and is being amortized except where such excess is attributable to land.

The cost of property and plant of Bathurst Paper Limited at acquisition in 1966 has been reduced by the gain (represented by the excess of book value over purchase price) on (a) the preferred shares, 1963 Series, of Bathurst Paper Limited purchased for cancellation and (b) the preferred shares, 1966 Series of the Corporation purchased for cancellation and which were originally issued in exchange for Bathurst Paper Limited Class A and common shares at the time of acquisition.

Foreign exchange

Assets and liabilities in foreign currencies are translated into Canadian dollars at exchange rates prevailing at the balance sheet date for working capital items and at approximate exchange rates prevailing at the transaction dates for non-current assets and liabilities. Income and expenses other than depreciation are translated at average exchange rates prevailing during the year except for those of the German subsidiaries which are translated at year-end exchange rates. Depreciation is translated at historic exchange rates.

Inventory valuation

Expenditures on woods operations are carried at cost. Pulpwood, chips, sawlogs and wood residues at mills, other raw materials, manufacturing supplies and stores are carried at average cost. The cost of work in process and finished goods inventories includes raw materials, direct labour and certain manufacturing overhead expenses; these inventories are carried at the lower of average cost and net realizable value. Provision is made for slow-moving and obsolete inventories.

Investments

Portfolio investments are stated at cost less any write-downs for declines in value. The investment over which the Corporation has significant influence and in the joint venture are accounted for by the equity method.

Property and plant and depreciation

Mills, plants and other properties are stated at cost less deductions for retirements, disposals and gains on repurchase of preferred shares as described in Principles of consolidation.

Depreciation, calculated principally on the straight-line method, is charged to operations at rates based upon the estimated useful life of each depreciable property.

Depletion is charged on timber limits on the basis of wood cut each year. The cost of rights is amortized on the straight-line method over the life of the wood supply agreement. The major portion of the Corporation's timber limits and rights is carried in the accounts at nominal value and, therefore, no depletion is charged thereon.

On retirement or disposal of property and plant, the Corporation removes from the accounts the cost of the assets and the related accumulated depreciation. Gains and losses on the disposal of assets are included in earnings.

Maintenance and repairs

Maintenance and repairs are expensed in the year in which they are incurred. Expenditures which result in a material enhancement of the value of the facilities involved are treated as additions to property and plant.

Research and development

Research and development expenditures other than capital expenditures relating thereto are charged to earnings in the year in which they are incurred.

Pensions

The Corporation and its Canadian subsidiaries have contributory, trusteed and funded pension plans. The current service cost portion is charged to earnings as incurred. Experience deficiencies are being funded and charged to earnings over a five-year period. Unfunded liabilities are being funded and charged to earnings over a 15 year period except those incurred prior to 1978 which are being amortized over a 17 year period.

Income taxes

The Corporation follows the tax allocation basis in accounting for income taxes. Deferred income taxes shown on the financial statements represent taxes deferred mainly in respect of capital cost allowance claimed for tax purposes in excess of depreciation charged in the accounts. Income tax credits relating to capital expenditures are accounted for as a reduction in income taxes in the year realized.

Notes to Consolidated Financial Statements December 31, 1978

1. Segmented information

The directors have determined the classes of business of the Corporation to be (i) pulp and paper and (ii) packaging.

	1978		1977	
	Net Sales	Operating Profit	Net Sales	Operating Profit
			(in thousands of dollars)	
Pulp and paper	**$ 522,970**	**$ 99,448**	$410,153	$ 47,753
Packaging	**587,924**	**39,285**	491,786	24,920
Inter-class eliminations	**(32,051)**	**(1,222)**	(33,074)	1,146
	$1,078,843	**137,511**	$868,865	73,819
Interest expense		**26,930**		26,823
Potential exchange charges on German term bank loan		**10,440**		7,510
Other corporate expenses – net		**4,377**		7,690
Earnings before income taxes, minority interest and extraordinary credit		**$ 95,764**		$ 31,796

2. Income taxes

	1978	1977
	(in thousands of dollars)	
Current income taxes	**$ 28,169**	$ 9,032
Less: Income tax credits relating to capital expenditures	**6,016**	467
Income tax reductions relating to the 3% inventory allowance	**1,947**	1,865
	20,206	6,700
Deferred income taxes	**16,144**	3,338
	$ 36,350	$ 10,038

The Corporation, on the advice of tax counsel, has filed notices of objection to income tax reassessments issued by the taxation authorities of Canada and Ontario for the years 1971 to 1975. These reassessments disallowed the deduction of certain interest payments to a non-resident subsidiary and certain insurance costs incurred by the Corporation. The income tax assessed and related interest amounting to $2,472,000 has been paid. No provision has been made for these costs pending final disposition of the objection.

3. Extraordinary credit

	1978	1977
	(in thousands of dollars)	
Gain from sale of investment in The Price Company Limited	**$ 1,568**	$ —
Gain from settlement of insurance claim relating to Braeside sawmill fire loss, less income taxes of $677,000	**—**	5,473
Provision for divestment of Bulkley Valley Forest Industries Limited no longer required	**—**	1,282
Charges for shutdown of newsprint machines at Cap-de-la-Madeleine, Quebec, containerboard mill at Luebbecke, West Germany, and sawmill at New Richmond, Quebec, less income tax credits of $3,412,000	**—**	(5,394)
	$ 1,568	$ 1,361

4. Inventories

	1978	1977
	(in thousands of dollars)	
Expenditures on woods operations	**$ 41,645**	$ 45,411
Pulpwood, chips, sawlogs and wood residues at mills	**36,583**	45,324
Other raw materials and supplies	**61,128**	56,913
Work in process and finished goods	**69,836**	80,073
	$209,192	$227,721

5. Property and plant

	Gross	Accumulated depreciation and depletion	1978 Net	1977 Net
			(in thousands of dollars)	
Pulp, paper, paperboard and lumber mills	**$506,569**	**$252,055**	**$254,514**	$250,512
Converting plants	**127,733**	**60,761**	**66,972**	65,232
Glass plants	**111,823**	**59,331**	**52,492**	56,519
Woodlands	**13,449**	**9,008**	**4,441**	4,994
Timber limits and rights	**9,066**	**4,998**	**4,068**	4,243
Other	**16,021**	**6,396**	**9,625**	11,842
	$784,661	**$392,549**	**$392,112**	$393,342

The following rates apply to those assets being depreciated on the straight-line method:	Buildings	Equipment
Pulp, paper, paperboard and lumber mills	2½%	6%
Converting plants	3%–5%	8%
Glass plants	5%	9%

6. Investments

	1978	1977
	(in thousands of dollars)	
Portfolio:		
Abitibi Paper Company Ltd. (market value $34,161,000)	**$ 31,400**	$ —
Rolland Paper Company, Limited (market value $4,830,000; 1977 $2,484,000)	**4,065**	4,065
The Price Company Limited	**—**	15,286
Other securities for which no market quotations are available and loans of a non-current nature	**9,323**	9,324
	44,788	28,675
Joint venture	**5,322**	—
Associated company	**2,592**	2,176
	$ 52,702	$ 30,851

7. Advances to trustees under stock option and purchase plans

Advances to trustees consist of $1,327,000 outstanding under the Exercised Option Purchase Plan established in 1972 and $250,000 outstanding under the Executive Employee Stock Purchase Plan established in 1969. Of these amounts, $1,325,000 is owing to the trustees from certain officers, one of whom is a director.

8. Contingent charges

	1978	1977
	(in thousands of dollars)	
Balance at beginning of year	**$ 20,268**	$ 16,919
Provision for estimated potential foreign exchange charges on repayment of German term bank loan	**10,440**	7,510
Charges and provision no longer required associated with divestment of Bulkley Valley Forest Industries Limited	**—**	(4,161)
Balance at end of year being the estimated potential foreign exchange charges on repayment of the German term bank loan	**$ 30,708**	$ 20,268

9. Long-term debt

	1978	1977
	(in thousands of dollars)	
Consolidated-Bathurst Inc.		
5.85% sinking fund debentures, Series A, 1990 (1978 U.S. $12,385,000; 1977 U.S. $13,469,000)	**$ 13,316**	$ 14,482
6⅜% sinking fund debentures, Series B, 1991 (1978 U.S. $11,602,000; 1977 U.S. $12,693,000)	**12,490**	13,664
8⅞% serial debentures, Series C	**—**	1,250
8¾% sinking fund debentures, Series C, 1993	**12,185**	12,185
Income debentures, Series E, due 1980 to 1987, interest rate ½ Canadian bank prime plus 1½% to 1982 and 1¾% thereafter	**50,000**	50,000
9% sinking fund debentures, Series F, 1992 (1978 U.S. $24,000,000; 1977 U.S. $25,000,000)	**25,903**	26,982
German term bank loans – note 9(a)		
(DM 313,000)	**—**	84
(DM 80,000,000)	**—**	21,452
Carried forward	**$113,894**	$140,099

		1978	1977
	Brought forward	**$113,894**	$140,099
Bathurst Paper Limited			
6% first mortgage sinking fund bonds, Series A, 1984		**4,515**	7,023
6% sinking fund debentures, Series A, 1984		**3,678**	4,374
German term bank loan – note 9(a) (DM 80,000,000)		**21,452**	—
Consolidated-Bathurst Pontiac Limited			
11% first mortgage sinking fund bonds, Series A, 1995, retractable in 1985		**29,732**	31,225
Consolidated-Bathurst (N.B.) Limited			
Term bank loan		**—**	4,900
Domglas Inc. and subsidiaries			
9½% sinking fund debentures, Series A, 1990		**21,325**	22,016
Term bank loans, prime plus ¾ of 1%, 1980		**9,000**	14,100
Other		**3,028**	4,523
Subsidiaries in the Federal Republic of Germany			
Term bank loans, various interest rates, due 1979 to 1992 (1978 DM 61,648,000; 1977 DM 63,048,000)		**29,344**	23,905
Other subsidiaries		**46**	539
		236,014	252,704
Less: Long-term debt due within one year, at historic exchange rates		**7,783**	7,057
		$228,231	$245,647

(a) In December 1978 the Corporation's DM 80,000,000 7½% term loan due July 1, 1985 was assumed by Bathurst Paper Limited, a subsidiary company. This loan is secured by the pledge of shares of the German subsidiary and of shares in certain Canadian subsidiary companies.

(b) Excluding the debt of German subsidiaries, the net cost of repayment of debentures and loans due in foreign currencies at December 31, 1978 (after the provision of $30,708,000 for estimated potential foreign exchange charges on repayment of the German term bank loan) exceeds by approximately $4,883,000 the Canadian dollar amounts recorded in the accounts.

(c) Based on exchange rates at December 31, 1978, estimated payments required to meet all maturities and sinking fund requirements annually to 1988 are:
1979–$ 9.8 million; 1980–$25.1 million; 1981–$18.1 million; 1982–$18.9 million; 1983–$18.4 million; 1984–$19.2 million; 1985–$66.8 million; 1986–$14.9 million; 1987–$27.1 million; 1988–$ 7.8 million.

10. Minority interest

	1978	1977
	(in thousands of dollars)	
Bathurst Paper Limited		
5¼% cumulative redeemable preferred shares, 1963 Series, par value $20 each	**$ 2,832**	$ 3,968
Domglas Inc.		
Common shares	**—**	1,928
	$ 2,832	$ 5,896

11. Continuance and stated capital

The stated capital is represented by:	1978	1977
	(in thousands of dollars)	
Preferred shares		
Authorized		
6,000,000 shares (1977 – 3,156,664) of which 1,118,794 shares are designated as 1966 Series and 800,000 as 1978 Series		
Issued		
1966 Series – 1,051,156 shares (1977 – 1,045,808)	**$ 26,279**	$ 26,145
1978 Series – 800,000 shares (1977 – nil)	**20,000**	—
	$ 46,279	$ 26,145
Common shares (Class A and Class B shares are inter-convertible and identical)		
Issued		
20,991,230 Class A common shares (1977 – 20,437,473)	**$155,338**	$ 83,858
1,390,762 Class B common shares (1977 – 1,449,129)	**10,510**	5,946
	$165,848	$ 89,804

Effective November 23, 1978, the Corporation was continued under the Canada Business Corporations Act and the Articles of Continuance also split the Class A and Class B common shares 3 for 1, empowered the Corporation to issue an unlimited number of such shares, and increased the number of authorized preferred shares to 6,000,000.

Other changes in issued capital during the year were:

(a) Exercise of 1968 share purchase warrants entitling holders to 495,390 Class A common shares at $20 per three shares.
(b) Under the provisions of Section 83(1) of the Income Tax Act of Canada and Section 395 of the Taxation Act of Quebec, the Corporation

transferred $72,741,000 from retained earnings to common shares and elected that the resulting deemed dividend be considered to be paid out of 1971 capital surplus on hand.

(c) Issued at $25 per share, 800,000 preferred shares, 1978 Series and 43,218 preferred shares, 1966 Series.

(d) Purchased and cancelled 37,870 preferred shares, 1966 Series, at a cost of $749,000, having a book value of $947,000.

The preferred shares are redeemable at par and are non-voting unless the Corporation fails to pay, in the aggregate, eight quarterly dividends. The 1966 Series are entitled to cumulative dividends at an annual rate of $1.50 per share; the 1978 Series are entitled to cumulative dividends at an annual rate, applied to $25 per share, equal to the lesser of (i) 9% and (ii) one-half of the average Canadian prime rate plus 1¾%, calculated quarterly.

Subject to provisions in certain covenants in the Trust Deeds securing the debentures and in the provisions attaching to the preferred shares, the Corporation at its option may redeem on 30 days' notice (i) the 1966 Series at $26 per share plus all unpaid dividends accrued thereon and (ii) commencing January 1, 1980, the 1978 Series at $25 per share plus all unpaid dividends accrued thereon. Unless the market price is in excess of the redemption price, the Corporation is obliged to make all reasonable efforts to purchase for cancellation 38,648 preferred shares, 1966 Series annually. Also the Corporation shall invite tenders for the purchase of 80,000 preferred shares, 1978 Series, in 1981 and 1982 and the balance of such shares annually thereafter.

Dividends, other than stock dividends, are subject to restrictions in the abovementioned covenants and provisions.

12. Commitments

(a) Various non-cancellable lease agreements having an initial or remaining term of more than one year exist for property and plant. The 1979 rental payments relating thereto amount to $11,200,000 and have terms not in excess of fifteen years for office space, converting plants and equipment and mill equipment and eight years for automotive and woodlands equipment.

(b) At December 31, 1978, outstanding commitments for capital expenditures under purchase orders and contracts amounted to approximately $19,400,000.

(c) Certain of the pension plans of the Corporation and its subsidiaries have unfunded past service liabilities which were actuarially estimated to be $28,900,000 at December 31, 1978 ($22,500,000 at December 31, 1977) of which $ 2,700,000 ($3,000,000 at December 31, 1977) represents an experience deficiency. The German subsidiaries have non-funded pension plans and the provision has been actuarially calculated in accordance with German legislation.

13. Other information

(a) The Corporation and its Canadian subsidiaries were to December 31, 1978, subject to the anti-inflation legislation enacted by the Government of Canada. In the opinion of management, the Corporation and its Canadian subsidiaries have, in all material respects, complied with the guidelines.

(b) The aggregate direct remuneration paid or payable in 1978 by the Corporation and its subsidiaries to the directors and senior officers was $2,818,000 (1977 – $1,592,000).

Historical Summary

		1978*	1977*	1976*
			(in thousands of dollars)	
Sales, earnings and dividends	Net sales	**$1,078,843**	$868,865	$745,193
	Depreciation and depletion	**36,022**	32,484	28,659
	Interest – both short and long-term	**26,930**	26,823	22,941
	Earnings before extraordinary items	**59,147**	21,355	18,240
	Per common share	**2.60**	0.90	0.76
	Extraordinary items, net of taxes	**1,568**	1,361	—
	Net earnings (loss) per common share	**2.67**	0.97	0.76
	Dividends per share			
	Preferred – 1966 Series	**1.50**	1.50	1.50
	– 1978 Series	**0.64**	—	—
	Common	**$0.75**	$0.67	$0.67
Property and plant	Property and plant – gross	**$ 784,661**	$769,237	$730,763
	Accumulated depreciation and depletion	**392,549**	375,895	363,477
	Additions to property and plant	**47,475**	53,783	56,678
	Maintenance and repair expense	**$ 73,038**	$ 69,889	$ 58,267
Working capital and cash flow	Working capital at end of year	**$ 263,141**	$209,233	$157,860
	Ratio – current assets to current liabilities	**2.7 to 1**	2.2 to 1	1.9 to 1
	Cash flow per common share	**$5.25**	$2.96	$2.24
Provisions	German pensions	**$ 12,829**	$ 11,199	$ 7,404
	Contingent charges	**$ 30,708**	$ 20,268	$ 16,919
Long-term debt		**$ 228,231**	$245,647	$178,837
Minority interest		**$ 2,832**	$ 5,896	$ 5,877
Shareholders' equity	Stated capital			
	Preferred	**$ 46,279**	$ 26,145	$ 27,094
	Common	**165,848**	89,804	89,803
	Retained earnings	**120,317**	150,940	144,384
	Total	**$ 332,444**	$266,889	$261,281
	Book value per common share	**$12.79**	$11.00	$10.70
Shares outstanding	Preferred	**1,851,156**	1,045,808	1,083,755
	Common	**22,381,992**	21,886,602	21,886,377

*1978 – Reflects sale of Wallaceburg glass plant to the joint venture in October.

*1977 – Reflects consolidation of one corrugated container plant from April, two folding carton plants from May and one sawmill from September.

*1976 – Reflects consolidation of Ampak Limited, Cyrmac Plastics Limited, Plant-Kimble Ltd. and Grundstucks-verwaltungsgesellschaft Altona mbH.

(in thousands of dollars)

1975	1974*	1973*	1972*	1971	1970	1969	1968*
$643,719	$689,009	$497,683	$348,055	$343,362	$353,944	$348,087	$295,472
26,150	25,658	21,500	16,534	17,942	19,241	20,492	18,538
18,812	18,445	14,518	10,573	12,773	13,523	11,960	10,012
32,599	47,712	19,870	6,181	127	274	10,239	12,811
1.42	2.37	0.92	0.18	(0.15)	(0.14)	0.41	0.56
—	14,608	(900)	63	(49,885)	(12,339)	—	(4,950)
1.42	3.13	0.87	0.19	(2.90)	(0.77)	0.47	0.45
1.50	1.50	3.38	1.12	—	1.50	1.50	1.50
—	—	—	—	—	—	—	—
$0.67	$0.75	$ —	$ —	$ —	$0.17	$0.33	$0.33
$678,302	$634,033	$611,733	$500,175	$515,915	$509,947	$507,999	$487,044
339,692	317,097	298,617	245,173	241,660	227,569	213,048	197,836
49,740	36,992	30,242	14,968	10,516	22,948	25,730	16,234
$ 44,467	$ 45,861	$ 29,724	$ 19,809	$ 17,946	$ 19,751	$ 19,360	$ 16,747
$159,084	$133,045	$ 81,066	$ 77,303	$ 82,519	$ 88,399	$111,155	$110,016
2.2 to 1	1.9 to 1	1.7 to 1	2.0 to 1	2.1 to 1	2.1 to 1	3.0 to 1	3.1 to 1
$2.98	$4.76	$2.54	$1.19	$0.80	$1.10	$1.79	$1.79
$ 6,418	$ 4,937	$ 2,644	$ 2,103	$ 1,823	$ 1,654	$ 1,293	$ 1,094
$ 17,607	$ 15,985	$ 15,543	$ 18,820	$ 33,100	$ —	$ —	$ —
$157,176	$129,896	$141,968	$130,751	$149,179	$159,812	$169,718	$159,891
$ 6,291	$ 6,502	$ 19,676	$ 6,394	$ 6,315	$ 6,000	$ 6,334	$ 6,289
$ 28,067	$ 31,078	$ 47,229	$ 47,229	$ 47,229	$ 47,229	$ 47,229	$ 47,229
88,695	88,626	42,091	39,518	39,337	39,337	38,425	36,543
142,320	125,943	80,929	68,344	64,216	113,924	130,828	128,239
$259,082	$245,647	$170,249	$155,091	$150,782	$200,490	$216,482	$212,011
$10.64	$9.89	$6.51	$5.74	$5.56	$8.45	$9.40	$9.28
1,122,684	1,243,119	1,889,144	1,889,144	1,889,144	1,889,144	1,889,144	1,889,144
21,720,102	21,700,812	18,905,412	18,178,812	18,127,812	18,127,812	18,001,662	17,753,454

*1974 – Reflects consolidation of Bobois and Lauenburger Wellpappenwerk GmbH from July and Dorchester Electronics from December.
*1973 – Reflects consolidation of Domglas Inc. from April.
*1972 – Reflects divestment of the U.S. tissue division.
*1968 – Reflects consolidation of Overseas division.

Impact of Inflation on Funds Flow

Research into inflation accounting continued on an international scale in 1978. The Canadian Institute of Chartered Accountants has formulated a proposal on current value accounting which is expected to be released as a position paper in 1979. In the United States, the Financial Accounting Standards Board issued, in December, a study on financial reporting and changing prices, and encourages experimentation by companies to develop techniques for reporting the effects of changing prices. In the United Kingdom, a report on current cost accounting is expected to be released in 1979.

The interim method proposed by the Ontario Committee on Inflation Accounting provides a good illustration of the capital maintenance concept. This method describes how funds generated from operations should be allocated to ensure the maintenance of the firm's capital – its productive capacity – during inflation. Although not forming part of the conventional financial statements, this method is based on reasonably objective calculations.

The statement below which incorporates three adjustments (inventories, property and plant, and financing) has been prepared for the year ended December 31, 1978 (with comparative figures for 1977) in accordance with the Committee's method for estimating the effect of inflation on the Corporation's funds available for distribution or expansion.

		1978		1977
				(in thousands of dollars)
Funds generated from operations		**$119,630**		$66,338
Less: Funds required to finance original cost of property and plant		**35,760**		32,316
Funds required to finance increased cost of maintaining operating capacity				
Inventories	**$ 8,155**		$10,627	
Property and Plant	**23,423**		20,029	
	31,578		30,656	
Deduct: Financing adjustment	**$13,708**	**17,870**	$12,434	18,222
Funds available for distribution or expansion		**$ 66,000**		$15,800

The inventories adjustment of $8,155,000 (1977 – $10,627,000) represents the difference between the historical cost of goods sold and their current cost at the date of sale.

The property and plant adjustment of $23,423,000 (1977 – $20,029,000) is the difference between depreciation as charged in the accounts of $35,760,000 (1977 – $32,316,000) and depreciation indexed for the effect of inflation of $59,183,000 (1977 – $52,345,000) using the business investment component of the Gross National Expenditures implicit price index.

The financing adjustment of $13,708,000 (1977 – $12,434,000) demonstrates the extent to which the additional funds required to finance the increased cost of maintaining operating capacity may be available from borrowings, on the assumption that the Corporation's debt to equity structure is maintained. This offsetting amount is therefore included in the adjustments in order to arrive at the funds available for distribution to shareholders or expansion after taking into account the Corporation's potential use of debt financing.

The funds generated from operations totalled $119,630,000 in 1978, an increase of 80% from 1977. However, after provision for capital maintenance costs of $53,630,000 these funds are reduced to $66,000,000, which represents the funds available for distribution to shareholders or expansion.

The Corporation intends to continue to participate actively in the effort to develop practical and meaningful reporting standards to reflect the impact of inflation on financial results.